



# Citizens Finance Review Commission

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## Transaction Privilege Tax on Interstate Telecommunications

Prepared for the Citizens Finance Review Commission

by

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## 1. **What it is**

Currently the Arizona transaction privilege tax on telecommunications businesses is levied only on *intra*state telecommunications. This means that only telephone calls where both the caller and the recipient of the call are located in Arizona are taxed. Calls by an instate caller to a telephone number located out of state are not taxed by the state or cities.<sup>1</sup> Intrastate telecommunications is defined as transmitting signs, signals, writings, data or other information if the information transmitted originates and terminates in this state.

The proposal before this commission is extending the tax on telecommunications to *inter*state transmissions of telephone calls. This discussion does not address issues related to cable television or satellite television services.

## 2. **How it would be administered**

The Department of Revenue would continue to enforce collection of TPT on telecommunications companies.

## 3. **Impact on Existing Revenue Systems**

Generally expanding the tax base would result in increased TPT revenues for the state and, through revenue sharing, to the cities. The Tax Expenditure Report does not include an amount attributable to the revenue that would be generated by expanding the tax base for telecommunications businesses to interstate telecommunications.

## 4. **Cost**

Arizona's transaction privilege tax is imposed on the telecommunications business. While it is common practice for the tax to be passed on to the customer the legal liability for the tax rests with the entity engaged in business. Several court cases have held that if a state that imposes a transaction privilege tax attempts to tax interstate transactions, the tax must include a mechanism to apportion the tax or provide a credit mechanism to ensure that the same transaction is not taxed by two or more states. Therefore, expanding the tax base to interstate telecommunications may increase the cost of administering TPT on telecommunications businesses.

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<sup>1</sup> A.R.S. § 42-5062.

## 5. Policy Considerations

The nature of Arizona's TPT is a business privilege tax on gross receipts. The burden of the tax is on the operator of the business in question. The United States Supreme Court has made it clear that a transaction privilege tax on an interstate transaction will violate the Commerce Clause in the absence of fair apportionment or a credit to ensure that the income from the interstate transaction will not be subject to tax in multiple jurisdictions.<sup>2</sup> The Supreme Court held that Illinois' tax on the gross charge for interstate telecommunications originated or terminated in Illinois and charged to an Illinois service address didn't violate the Commerce Clause under four-part test in the *Complete Auto* case. The tax was internally consistent because only one state would tax any interstate call if all states taxed only interstate calls charged to an in-state service address. The tax passed external consistency test—that the tax is only on revenue from interstate activity that reasonably reflects in-state part of activity taxed. The risk of multiple taxation was low because only two states would have nexus to tax an interstate call. Actual multiple taxation is avoided by allowing credit for tax paid on same call in another state.<sup>3</sup>

Interstate telecommunications related to customers of wireless services in Arizona are already being taxed. Arizona has conformed with the federal Mobile Telecommunications Sourcing Act (P.L. 106-252.). The federal Act requires that all wireless calls be sourced to the customer's residential or business address, whichever is the place of primary use, regardless of the jurisdiction that the mobile telecommunications services originate from, terminate in, or pass through.<sup>4</sup> Additionally, the other states that have a gross receipts tax similar to Arizona, such as New Mexico, Hawaii and South Dakota, impose their tax on interstate telecommunications. Note that the statute that imposes Hawaii's tax on interstate telecommunications includes an apportionment factor.<sup>5</sup>

Arizona could extend the TPT to interstate telecommunications if the call originates or terminates in Arizona and the service address is in Arizona. The statute should include a mechanism to either apportion the tax or grant a credit

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<sup>2</sup> *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 131 L. Ed. 2d 261, 115 S. Ct. 1331 (1995).

<sup>3</sup> *Goldberg v. Sweet* (1989) 488 U.S. 252, 109 S.Ct. 582, 102 L.Ed. 2d 607

<sup>4</sup> A.R.S. § 42-5034.01

<sup>5</sup> See, Haw. Rev. Stat. § 237-13(6)(D); NMSA 1978 § 7-9C-3; S.D. Codified Laws § 10-45-6.1

for taxes paid to another jurisdiction, however, to ensure that the tax does not violate the Commerce Clause.<sup>6</sup>

## **6. Economic Impact**

Expanding the tax base to include interstate telecommunications should result in increased revenue to the state. Telecommunications services are taxable at the customer's location. A telecommunications company cannot move out-of-state to avoid paying the tax. Additionally, the requirement to remit TPT on interstate calls as well as intrastate calls may simplify the telecommunications companies' tax reporting responsibility as there would no longer be a need to distinguish between intrastate calls and interstate calls when calculating the tax due on a customer's monthly bill.

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<sup>6</sup> *Southern Pacific Transportation Company, Inc. v. State of Arizona, Town of Clifton*, 202 Ariz. 326, 44 P.3d 1006 (App. 2002)